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COMMISSIONER

*The Commonwealth of Massachusetts*  
*Department of Revenue*  
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August 16, 1984

You inquire whether obligations of the United States government and tax-exempt bonds of the government of Puerto Rico and the interest earned on such obligations are included in the determination of the Massachusetts corporate excise tax imposed on domestic business corporations by Massachusetts General Laws Chapter 63, Section 32.

Stocks and obligations of the United States government are exempt from taxation by a state or political subdivision of a state. The exemption applies to each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax, except:

(1) a nondiscriminatory franchise tax or another nonproperty tax instead of a franchise tax, imposed on a corporation; and

(2) an estate or inheritance tax. (31 U.S.C. § 3124(a)).

The fundamental issue in cases concerning the validity of state excise taxes is whether the tax is a franchise tax or a property tax. If the subject of the tax is the corporate franchise, government obligations or the interest thereon may be included in the measure of the tax. If the subject of the tax is the capital or the property of the corporation, the tax will be deemed an invalid tax on the government obligations. Commissioner of Revenue v. Massachusetts Mutual Life Insurance Co. 384 Mass. 607 (1981).

A tax on the corporate franchise is valid despite the

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inclusion of federal bonds in the determination of net worth. The U.S. Supreme Court has consistently upheld franchise taxes measured by a yardstick which includes tax-exempt income or property, even though a part of the economic impact of the tax may be said to bear indirectly upon such income or property. Werner Machine Co. v. Director of Division of Taxation, 350 U.S. 492, 76 S. Ct. 534 (1956).

The Massachusetts corporate excise is composed of two portions:

(1) A tax of \$2.60 per \$1,000 on taxable Massachusetts tangible property if the corporation is a tangible property corporation, or on taxable net worth if the corporation is an intangible property corporation, and

(2) A tax of 9.50 percent on net income attributable to Massachusetts. (G.L. c. 63, § 32).

The net worth of a corporation is equal to the book value of its total assets on the last day of the taxable year with certain adjustments not relevant here. (G.L. c. 63, § 30(8)). Obligations of the United States government and tax-exempt bonds of the government of Puerto Rico are includible in the determination of the net worth of an intangible property corporation since these intangibles are included in the book value of its assets.

The net income of a corporation is equal to federal gross income plus the interest from obligations of any state, including Massachusetts, less federal deductions, but not federal credits. (G.L. c. 63, § 30(5)). Federal gross income means all income from whatever source derived. (I.R.C. § 61(a)). Federal gross income does not include interest on the obligations of a state, a territory, or a possession of the United States, or any political subdivision of any of the foregoing, or of the District of Columbia. (I.R.C. § 103(a)).

Interest on United States government obligations is includible in the determination of a domestic corporation's net income because such interest is includible in federal gross income.

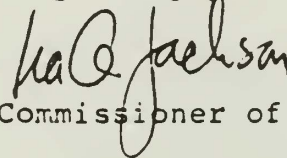
The interest earned on federal obligations may properly be considered in the determination of net income for the purpose of the excise tax imposed on domestic corporations since the excise is a nondiscriminatory franchise tax and

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excepted from the exemption under 31 U.S.C. § 3124(a). See Commissioner of Revenue v. Massachusetts Mutual Life Insurance Co. supra.

Chapter 63, Section 30(5) specifically includes the interest from bonds, notes and evidences of indebtedness of any state in the definition of gross income. Chapter 63, Section 30(13) defines state as "any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico..." Therefore, the interest earned on tax-exempt bonds of the government of Puerto Rico is included in the determination of a domestic corporation's net income.

Very truly yours,

A handwritten signature in dark ink, appearing to read "Ha Q. Jackson", written in a cursive style.

Commissioner of Revenue

IAJ:VGS:mf

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